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Supreme Court of the United States

October Term, 1945

Nos. ~~848, 849, 850, 851~~. 42 – 45

In the Matter of
AMERICAN FUEL AND POWER COMPANY,
INLAND GAS CORPORATION,
KENTUCKY FUEL GAS CORPORATION,
Debtors.

VANSTON BONDHOLDERS PROTECTIVE COMMITTEE, - - - - - - - - Petitioner,

versus

LOUIS A. GREEN AND ROBERT HEILBRUNN, Known in these Proceedings as the Green Committee, AND MORRIS GREEN, - - - Respondents.

VANSTON BONDHOLDERS PROTECTIVE COMMITTEE, - - - - - - - - Petitioner,

versus

CARL B. EARLY, DANIEL MATTHEWS, THOMAS MATTHEWS, JACK PATTON AND P. G. MEADOR, - - - - - - - - Respondents.

In the Matter of

VANHORN BONDHOLDERS PROTECTIVE COMMITTEE, - - - - - - - - Petitioner,

versus

LOUIS A. GREEN AND ROBERT HEILBRUNN, Known in these Proceedings as the Green Committee, AND MORRIS GREEN, Et AL., - - Respondents.

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

RESPONSE OF CARL B. EARLY, ET AL., RESPONDENTS.

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DEBTORS.

VANSTON BONDHOLDERS PROTECTIVE COMMITTEE, - - - - - - - - *Petitioner,*

v.

LOUIS A. GREEN AND ROBERT HEILBRUNN, KNOWN IN THESE PROCEEDINGS AS THE GREEN COMMITTEE, AND MORRIS GREEN, *Respondents.*

VANSTON BONDHOLDERS PROTECTIVE COMMITTEE, - - - - - - - - *Petitioner,*

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VANHORN BONDHOLDERS PROTECTIVE COMMITTEE, - - - - - - - - *Petitioner,*

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LOUIS A. GREEN AND ROBERT HEILBRUNN, KNOWN IN THESE PROCEEDINGS AS THE GREEN COMMITTEE, AND MORRIS GREEN, ET AL., - - - - - - - *Respondents.*

On Petition for Writs of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

RESPONSE OF CARL B. EARLY, ET AL., RESPONDENTS.

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals is reported 151 Fed. (2d) 470. The District Court rendered no opinion, but, during argument, stated the grounds for its decision (R. 148) and, thereafter, made an order and judgment embodying findings of fact and conclusions of law (R. 348).

JURISDICTION.

The judgment sought to be reviewed was entered October 9, 1945 (R. 375), and a petition for rehearing was denied November 26, 1945 (R. 411). The petition for certiorari of Vanston Bondholders Protective Committee (Nos. 848, 849), was filed February 14, 1946, and the petition for certiorari of Vanhorn Bondholders Protective Committee (Nos. 850, 851), was filed February 15, 1946. In each petition for certiorari the jurisdiction of this Court is invoked under §240 of the Judicial Code, as amended, and the petition for certiorari of the Vanston Bondholders Protective Committee also invokes the jurisdiction of this Court under §24 of the Bankruptcy Act, as amended.

STATEMENT.

On February 1, 1928, the debtor, Inland Gas Corporation, a Delaware corporation, executed and delivered in the State of New York a deed of trust to Chatham Phenix National Bank & Trust Company and

James F. McNamara, Trustees, under which a first lien on all the property of the Inland Gas Corporation therein described, and which consisted of substantially all of its property, was given as security for the payment of an issue of $4,400,000.00 par value of 6½% first mortgage bonds maturing on the first day of February, 1938. The interest on the bonds was represented by coupons attached, payable semi-annually.

The bonds provided that they were payable:

> "at the principal office of the Chatham Phenix National Bank & Trust Company, or its successor in trust under the Indenture hereinafter mentioned (hereinafter called the Trustee), in the Borough of Manhattan, City and State of New York, or, at the option of the bearer or such registered owner, at the principal office of the Continental National Bank & Trust Company, in the City of Chicago, State of Illinois." (R. 354)

The coupons provided that they were payable:

> "at the principal office of Chatham Phenix National Bank & Trust Company, in the Borough of Manhattan, City and State of New York, or at the option of the bearer, at the principal office of the Continental National Bank & Trust Company in the City of Chicago, State of Illinois." (R. 359-360)

The trust indenture securing the bonds and coupons provides for the payment of interest on defaulted bonds and coupons, from their respective due dates until paid, at the same rate as that applicable to the bonds before

maturity, but there is no such provision in either the bonds or coupons attached thereto.

At the time of the institution of bankruptcy proceedings substantially all of the bonds were past due and unpaid, as is true of the interest coupons which matured after August 1, 1930. The past due coupons had not been detached from the bonds or negotiated to third parties. The record contains no proof that the holders of any of the past-due bonds or coupons exercised their option to require payment thereof in Chicago, Illinois, or that the option was so exercised in respect of any of the bonds or coupons that were actually paid.

Inland Gas Corporation also has outstanding and past due since February 1, 1938, $1,450,000.00 par value of 7% debentures and $400,000.00 par value of 6% mortgage notes. No interest has been paid on the debentures since August 1, 1930, and no interest has been paid on the mortgage notes since January 2, 1930. The debentures and the mortgage notes are secured by a second mortgage on the same property embraced in the deed of trust securing the bond issue.

The District Court, on petition by a First Mortgage Bondholders Committee for a distribution upon first mortgage bonds, ruled that the validity of the provision in the trust indenture for the payment of interest on defaulted interest coupons attached to the first mortgage bonds was controlled by the law of the State of New York, and that under the law of that State that provision was valid. He accordingly ruled that the holders of the bonds and attached coupons

were entitled to the payment of the face of the bonds and of the attached coupons and, in addition thereto, to simple interest on the bonds and to simple interest on the past-due coupons from the date of their respective maturities until paid at 6½% per annum. The result of this ruling was to deny the second mortgage-holders any substantial recovery whatever on their securities.

On appeal to the Circuit Court of Appeals for the Sixth Circuit, the ruling of the lower court was reversed, the Circuit Court holding, as did the District Court, that validity of the contract to pay interest on past-due coupons must be determined by the law of New York. That Court, however, held that, under the law of New York, the contract to pay interest on the defaulted coupons was against the public policy of that State and void. This proceeding seeks a review of the decision of the Circuit Court of Appeals.

ARGUMENT.

The petition of the Vanston Bondholders Protective Committee for certiorari states that the case at bar presents two questions justifying a review by this Court. In the language of the petition those questions are:

> "1. Whether in determining the rule for the choice of the governing local law concerning the validity of an interest provision in a multi-State contract made by a Debtor in Chapter X Proceedings the bankruptcy court should select the choice of law rule of the forum State.

2. Whether such interest provision is invalid, although it does not violate the public policy of any of the States involved, nor of the United States, and would have been upheld if it had been litigated in the courts of any of such States."

We shall consider those questions in the order stated.

Question 1.

We believe in the light of this record it may be categorically stated that Question No. 1 posed in the petition is not in this record. The petition proceeds upon the theory that the contract, although made in New York, was to be performed in the State of Illinois, and that, therefore, the record presents the question of whether the validity of the contract to pay interest on past-due coupons should be resolved according to the law of New York, the State in which the contract was made, or according to the law of Illinois, the alleged State of performance. If petitioners' assumption that the contract was to be performed in Illinois is erroneous, then the entire basis for the claimed existence of Question No. 1 disappears.

As shown in our statement, each of the coupons provided that it was payable "at the principal office of Chatham Phenix National Bank & Trust Company, in the Borough of Manhattan, City and State of New York, or, *at the option of the bearer,* at the principal office of the Continental National Bank and Trust Company in the City of Chicago, State of Illinois" (Emphasis ours). This language is subject to only

one construction, and that is that there was only one absolute and unqualified place of payment fixed in the coupon; and that was New York. No coupon ever became payable in Chicago, unless and until the holder thereof had exercised his option to have it paid there. It is the general rule that where the place of performance is left to the option of one of the parties, that place remains undetermined until such party has exercised his option. *Restatement Conflict of Laws,* Sec. 356; *Liebeskind* v. *Mexican Light & Power Co.,* 116 Fed. (2d) 971, 973 (2d Cir.); *Lann* v. *United Steel Works Corp.,* 166 Misc. 465, 1 N. Y. S. (2d) 951; *Pan-American Securities Corp.* v. *Krupp Actiengesellschaft,* 169 Misc. 445, 451, 6 N. Y. S. (2d) 993, Affd. 256 N. Y. App. Div. 955, 10 N. Y. S. (2d) 205. On the other hand, it would seem axiomatic that if the contract specifically provides that the place of performance shall be at a designated place, unless one of the parties elects that the performance shall be elsewhere, the place fixed in the contract is the place of performance unless and until the option to designate otherwise has been exercised. Now, in this case, the holders of the coupons asserted their claim to interest on the coupons in the bankruptcy proceeding. The allowance of interest was resisted on the ground that the contract providing for the payment of interest was a New York contract and void against the public policy of that state. It would seem clear that in that situation, if the coupon holder desired to claim that the place of the payment of his coupon was Chicago, Illinois, the burden was upon him to show that he had

exercised his option to have payment made there. The record contains no such showing. It is familiar law that one claiming rights under an option must prove substantial compliance with the terms thereof.

The brief in support of the petition of the Vanston Committee, at page 14 in a footnote, suggests the futility of the holder demanding payment in Illinois, in the exercise of his option so to do, for the reason that at the time the coupons here involved matured, Inland was in receivership. Instead of that situation aiding petitioner's case, it seems to us that it all the more conclusively establishes New York as the contract place of payment. When the holders of coupons acquired them, they, in law, agreed that, unless and until they exercised their option, the place of payment should be New York. We fail to understand how the failure to exercise the option because of the futility of so doing can alter the situation. Whatever the reason for failure to exercise the option, it is a fact, nevertheless, that it was not exercised.

The opinion of the Circuit Court of Appeals refers to the fact that the record contains no evidence that any bondholder demanded payment in Illinois, and then proceeds to state:

> "New York is the state where the contracts were made and is also the primary place of performance. In all the circumstances, it would seem, therefore, that we must look to the law of New York for decisive guidance."

It seems to us from the quoted language that the Circuit Court of Appeals approached the problem pre-

sented on the premise that the contract was not only made in New York but was to be performed there.

The petition of the Vanston Committee states that the Circuit Court of Appeals "in choosing the governing law had first to determine which body of law was the proper source for the applicable rule determining such choice and it erroneously held that the law of the State in which the District Court was located determined the choice." We do not so understand the opinion. We understand that opinion, the Circuit Court concluded that under the Federal rule applicable to the *particular facts of the case*, the law of New York determined the validity of the contract. If the opinion, to the effect New York was the place of contracting as well as performance, is sound, undoubtedly, the Federal rule requires that the validity of the contract shall be determined by New York law. The Circuit Court of Appeals also examined the law of the State of Kentucky, and concluded that under the law of that state as applied to the facts, the validity of the contract must be determined by the law of New York. Hence, the Circuit Court of Appeals did not feel itself confronted with the necessity of determining whether the Kentucky rule or the Federal rule was controlling, as, in this case, they are exactly the same.

It is submitted that *Seeman* v. *Philadelphia Warehouse Company*, 274 U. S. 403 (1927); and *Cromwell* v. *County of Sac*, 96 U. S. 51 (1877), cited in petitioner's brief, if applicable in any case since *Erie R. Co.* v. *Thompkins*, 304 U. S. 64 (1938), have no application here. All that those cases decide is that if a con-

tract for the payment of money, with interest, is made in one state and by its terms is unconditionally payable in another, and the permissible rate of interest is higher in one of the states than in the other, the higher rate of interest may be collected, provided the arrangement is not a sham to permit the collection of a higher rate of interest than would have been permissible had the contract actually expressed the real agreement of the parties. Those cases, however, are not applicable to the case at bar, for, as demonstrated above, the contract under consideration here not only was made, but was to be performed, in New York.

Petitioner apparently recognize that the only justification for asking this Court to review the decision of the Circuit Court of Appeals is that a reversal would make for uniformity in the administration of the Federal bankruptcy law. It seems to us that the contention is fallacious. We assume that the uniformity with which this Court would be concerned is uniformity of result. Uniformity could not possibly result even should this Court reverse the Circuit Court of Appeals and hold that Illinois was the place of performance, and that in bankruptcy proceedings the validity of contracts must be determined by the law of the state of performance. There cannot be uniformity of result whether this Court decides that in such proceedings the choice of law must be that of the state of performance or leaves the choice to be made in accordance with the law of the forum. In either case the local factor will inevitably produce variability. The decisions of this Court disclose that where the

Federal bankruptcy statute does not provide any criteria, the Court has not sought uniformity of result, but has applied the applicable local law. Thus, it has been held that in bankruptcy proceedings the validity and construction of a contract executed more than four months before bankruptcy, and forming the basis of a claim filed in such proceedings, must be determined by state law. *Benedict, Receiver,* v. *Ratner,* 268 U. S. 353; *Security Mortgage Company* v. *Powers,* 278 U. S. 149; and that the effectiveness of a transfer as against a trustee in bankruptcy must be tested by the standards which the applicable state law would enforce against a good faith purchaser. *Corn Exchange Bank* v. *Klauder, Trustee,* 318 U. S. 434; *McKenzie* v. *Irving Trust Company,* 323 U. S. 365.

The rule which petitioner seeks to have the Court announce would make the choice of law rule, and in turn the validity of contracts, depend upon the basis of the jurisdiction of the Federal Court. In *Klaxon Co.* v. *Stentor Company,* 313 U. S. 487, this Court held that in diversity of citizenship cases, the Federal Courts, when deciding questions of conflict of laws, must follow the rules prevailing in the states in which they sit. Should petitioner's contention be upheld, the validity of the same contract would frequently be determined by the law of one state if its validity was involved in a diversity of citizenship proceeding, and by the law of an entirely different state if it was involved in a bankruptcy proceeding. Consider what would be the situation in respect of the very contract here involved, if we accept petitioner's premise that Illinois

is the state of performance. As we understand, the bulk of the property covered by the trust indenture is located in Kentucky. Suppose the trustee for the bondholders or the holders of coupons had brought suit in a Federal Court in Kentucky on the jurisdictional ground of diversity of citizenship to foreclose the mortgage. Under the thoroughly settled rule, as announced by the Kentucky cases hereafter to be noted, unquestionably, the validity of the contract to collect interest on the coupons would be determined by the law of New York, while in this bankruptcy proceeding it would be determined by the law of Illinois. It seems to us that a rule which makes the validity of a contract involved in a Federal Court proceeding depend upon no more substantial ground than the basis of the Court's jurisdiction would be so unreasonable and intolerable as to justify this Court in summarily rejecting the rule by a denial of the petition herein.

Question 2.

At p. 14 of the Vanston Committee brief appears this statement:

> "The interest provision is valid since (a) it does not violate the public policy of any of the States involved, nor of the United States, and (b) the provision would have been upheld had there been litigation concerning its validity in the Courts of any of the States involved."

The Circuit Court of Appeals opinion holds that the contract is in violation of the public policy of the

State of New York and sustains its conclusion by citation and analysis of many New York cases, as well as Federal cases. No reported New York case is in conflict with the cases cited in the Circuit Court of Appeals opinion. Among the many New York cases holding that such contracts as the one here involved are against the public policy of that State, we cite: *State of Connecticut* v. *Jackson,* I Johns Ch. 13 (1814); *M. & J. VanBenschooten* v. *Lawson,* 6 Johns Ch. 313 (1822); *Mowry* v. *Bishop,* 5 Page's Ch. 98 (1835); *Toll* v. *Hiller,* 11 Page's Ch. 228 (1844); *Forman* v. *Forman,* 17 Howard's Practice Rep. 255 (New York Supreme Court 1859); *Stewart* v. *Petrie,* 55 N. Y. 621 (1874); *Young* v. *Hill,* 67 N. Y. 162 (1876); *Bailey* v. *Buchanan County,* 115 N. Y. 297 (1889); *Williamsburg Savings Bank* v. *Town of Solon,* 136 N. Y. 465 (1893); *Continental Securities Company* v. *New York Central & H. Railroad,* 217 N. Y. 119 (1916), opinion by Mr. Justice Cardozo; *Newburger-Morris Company* v. *Talcott,* 219 N. Y. 505 (1916), opinion by Mr. Justice Cardozo; and *Chase National Bank* v. *Clark Henry Corporation,* 156 Misc. 767 (1935).

The Federal Courts have placed upon those State decisions the same construction as did the Sixth Circuit: *In Re: Columbus S. H. & H. R. Co.,* 109 Fed. 177 (1901 C. C. A. 6th); *American Brake Shoe & F. Co.* v. *Interborough Rapid T. Co.,* 11 Fed. Supp. 418 (1935 D. C. N. Y.); *Transbel Inv. Co.* v. *Roth,* 36 Fed. Supp. 396 (1940 D. C. N. Y.); and *In Re: Wisconsin Cent. Ry. Co.,* 63 Fed. Supp. 151 (1945 D. C. Minn.).

Against this array of cases, the petitioners cite only two reported cases: *Westchester Mortgage Co.* v. *Grand Rapids & Ionia Railroad Co.*, 246 N. Y. 194, 158 N. E. 70, and *American Brake Shoe & Foundry Co.* v. *Interborough Rapid Transit Co.*, 26 Fed. Supp. 954.

In the footnote on page 15 of the petition and brief filed by the Vanston Committee, reference is made to two unreported cases, which are not available to us. The *Westchester Railroad Company* case does not support petitioners' contention. It only held that in an action in New York on a note made, delivered and secured in Rhode Island, the essential provisions of which were to be performed in that State, the validity of its interest rate was determinable according to the laws of Rhode Island. It is admitted that the *American Brake Shoe & Foundry Co.* case, reported in 26 Federal Supplement, at page 945, supports the petitioners' contention, but it is submitted that the New York cases do not sustain the analysis, nor justify the differentiations undertaken to be made by Judge Patterson in that opinion. It is further submitted that one decision of a Federal District Court which has not been followed by later decisions in Federal District Courts does not establish that the Circuit Court of Appeals has decided a question of local law in a way probably in conflict with applicable local decisions.

It is admitted that the contract, had it been made in Kentucky, would not have violated the public policy of that State, but the statement in the brief to the effect that, if the contract in question here had been declared on in a Kentucky State Court, it would have been en-

forced, is not supported by the Kentucky cases. On the contrary, in an unbroken line of cases the Kentucky Court of Appeals has held that the validity of such a contract must be determined in accordance with the laws of the State where made.

Moody v. *Barker*, 188 Ky. 401, 403, 222 S. W. 89, announces the State rule:

> "It may be stated without exception that, if under the *lex loci contractus* the contract for any reason is void, it will be invalid everywhere, and will not be enforced by the *lex fori*, although it would be valid if executed in that jurisdiction."

Of the many Kentucky cases following the rule so announced, we cite: *Fry Bros.* v. *Theobold*, 205 Ky. 146, 148-149, 265 S. W. 498; *Cooper's Adm'r* v. *Lebus' Adm'rs*, 262 Ky. 245, 90 S. W. (2d) 33; *Deins' Adm'r* v. *Gibbs*, 257 Ky. 469, 78 S. W. (2d) 346; *Ford* v. *Buckeye State Ins. Co.*, 6 Bush 133; *Griswold* v. *Golding*, 8 Ky. L. Rep. 777, 3 S. W. 535; *Clarey* v. *Union Central Life Ins. Co.*, 143 Ky. 540, 136 S. W. 1014, and *Troendle, et al.* v. *Highleyman* (Ky.), 113 S. W. 812.

The petitioners cite (p. 16 of their brief) *Commonwealth Farm Loan Co.* v. *Caudle*, 203 Ky. 761, 263 S. W. 24; *William Glenny Glass Co.* v. *Taylor*, 99 Ky. 24, 34 S. W. 711, and *Pensacola & A. R. Co.* v. *Hilton's Trustee*, 147 Ky. 553, 144 S. W. 1077, as announcing a contrary rule, but a reading of those cases readily discloses that they do not justify the confidence placed in them by petitioners. In the *Commonwealth Farm Loan Company*, case, the Court stated that it *might* apply a rule that where notes are executed in one state

and payable in another, the parties may lawfully contract for the highest legal rate of interest permissible by the laws of either state. However, it did not apply such a rule in that case. Consequently that case cannot be accepted as modifying to any extent the rule laid down in the Kentucky cases above cited.

In the case of *William Glenny Glass Company* v. *Taylor, supra,* the note involved was void under New York Law, but valid under Kentucky law. The Court found as a fact, and any other finding would have been unjustified, that the note was executed in Kentucky and hence, under the Kentucky rule, its validity was determined under Kentucky law, even though payable in New York.

Pensacola & A. R. Co. v. *Hilton's Trustee, supra,* is inapplicable. The question here presented was neither raised nor considered by the Court. Questions that merely lurk in a record, but which are neither brought to the attention of the Court nor ruled upon are not to be considered as having been so decided as to constitute precedents. *Webster* v. *Fall,* 266 U. S. 507; *United States* v. *Mitchell,* 271 U. S. 9; *Bingham* v. *United States,* 296 U. S. 211; *Rex Coal Co.* v. *Campbell,* 213 Ky. 636.

It is submitted that, in the light of the foregoing authorities, the Circuit Court of Appeals correctly interpreted the New York and Kentucky cases. However, if there is any doubt on this point, we cannot believe the Court will grant *certiorari* merely to determine for itself whether the Circuit Court of Appeals correctly interpreted the decisions of the New York

and Kentucky Courts on the matter which has no national concern.

CONCLUSION.

The decision of the Circuit Court of Appeals was the result of careful consideration and is correct in all respects. There is no conflict between the Federal rule and the State rule as to the choice of local law, on the facts of the present case, and no question worthy of review is presented. The petitions for writs of *certiorari* should be denied.

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